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No. 95-1802

IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1995

RICHARD L. and KATHERINE E. COUCHOT,
Petitioners,

v.

THE STATE LOTTERY COMMISSION,
THE OHIO DEPARTMENT OF TAXATION and
J. KENNETH BLACKWELL,
TREASURER OF THE STATE OF OHIO,
Respondents.

On Petition for Writ of Certiorari to the Supreme Court of Ohio

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RESPONDENTS' BRIEF IN OPPOSITION

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QUESTION PRESENTED

May a State impose its income tax on the annual installment payments of the lottery winnings of a nonresident who physically entered the State to play the State's lottery and to claim his prize without offending the Commerce Clause or the Due Process Clause?

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On Petition for Writ of Certiorari to the
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RESPONDENTS' BRIEF IN OPPOSITION

STATEMENT

This case involves the authority of Ohio to impose its income tax on that part of the income of nonresidents which consisted of winnings from playing the State's lottery. In holding that Ohio had sufficient connections under the Due Process and Commerce Clauses to authorize it to exercise its power of taxation over such income, the Ohio Supreme Court applied the well-established principle that a State may tax the income of nonresidents that arises out of events or

transactions that occur in the State. This was the single, narrow issue decided below.

A. Factual Background

The facts are simple and straightforward. On March 2, 1988, Richard L. Couchot, a resident of Kentucky, crossed the Ohio River and physically entered Ohio for the specific purpose of purchasing an Ohio lottery ticket. On that same day, in a drawing held in Ohio, the numbers on Mr. Couchot's ticket were selected as the winning combination. Subsequent to that drawing, Mr. Couchot again physically entered Ohio to claim his prize. Pursuant to the regulations of the Ohio Lottery Commission in effect at that time, Mr. Couchot's prize winnings of $21,000,000 were payable in annual installments over a twenty-year period. It is these annual installments of Mr. Couchot's Ohio lottery prize winnings, and that income alone, that Ohio has subjected to its income tax.

B. The Proceedings Below

The Couchots' statement of the history of the case is essentially correct. Their version of the holdings of the Ohio Court of Appeals and Supreme Court is not. The Court of Appeals, in a decision based on an erroneous conjoining of the unrelated concepts of due process nexus and retroactivity (under the Ohio Constitution), held that Ohio's imposition of its income tax violated the Due Process Clause of the United States Constitution and the Retroactivity Clause of the Ohio Constitution, section 28, Article II. App. B. 28a. That court did not hold that the tax violated the Commerce Clause. In fact, the court found that the trial court erred in utilizing a Commerce Clause analysis. App. B. 26a.

Nor did the Court of Appeals broadly hold that Ohio could not impose its income tax on Ohio lottery winnings of nonresidents. To the contrary, citing *International Harvester Co. v. Wisconsin Dept. of Taxation*, 322 U.S. 435 (1944), the Court of Appeals found that the redeeming of an Ohio lottery ticket constitutes an event or transaction which would permit Ohio to tax winnings from the lottery. App. B. 27a-28a. It was only because Mr. Couchot won the Ohio lottery prior to a statutory amendment that specifically subjected lottery winnings to Ohio income tax that the court held the imposition to be unconstitutional. App. B. 28a. The timing question, however, raised an issue under the Retroactivity Clause of the Ohio Constitution, not a Due Process nexus issue under the U.S. Constitution.[1]

The Ohio Supreme Court granted review and reversed. Relying on *International Harvester* as well as other authorities, it upheld the State's imposition of income tax on Mr. Couchot's installment payments of Ohio lottery winnings. The Court properly focused on the connection between the State and the income it sought to tax. Finding that such income arose entirely out of an event that occurred exclusively in Ohio, the Court held that the requisite nexus existed.

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[1] The Ohio Supreme Court held that because the taxable event for income tax purposes is the receipt of income, the imposition of income tax on installments of Ohio lottery prize payments in years after the statutory enactment, which were the only winnings taxed by Ohio, did not offend the State Retroactivity Clause. App. A. 13a-14a.

REASONS WHY THE PETITION SHOULD BE DENIED

I. Introduction

This case does not present any momentous constitutional issue that demands this Court's review. Instead, it simply involves the application of an established, fundamental principle regarding the power of the states to tax income of nonresidents. The issue decided below was much narrower than that posed by the Couchots in their petition. Ohio is not seeking to extend its power to tax income of nonresidents to income that has no connection to Ohio. To the contrary, Ohio sought only to tax income of the Couchots which arose out of an event or transaction which occurred wholly within Ohio.

The only income of the Couchots that Ohio taxed were the annual installment payments which Mr. Couchot received as a result of playing and winning the Ohio lottery. It was only that income which Ohio claimed jurisdiction to tax. Ohio has not made any attempt to assert its power of taxation over any other income of the Couchots. Ohio readily concedes that it would have no right to tax such income because none of that other income arose from any event or transaction which occurred in Ohio and Ohio would therefore have no nexus with that other income.

The specific issue is whether Ohio may, within the strictures of the Due Process and Commerce Clauses, tax the annual installment payments of Ohio lottery prize winnings received by nonresidents who played and won the Ohio lottery. The Ohio Supreme Court, applying the controlling decisions of this Court, held that Ohio had sufficient nexus with that income under both the Due Process and Commerce Clauses to authorize the State to exercise its taxing power over that income. In so holding, the Ohio Supreme Court

was guided by the fundamental principle which controls the determination of the constitutional extent of the States' jurisdiction to tax the income of nonresidents:

> A state may tax such part of the income of a non-resident as is fairly attributable either to property located in the state or to events or transactions which, occurring there, are subject to state regulation and which are within the protection of the state and entitled to the numerous other benefits which it confers.

International Harvester Co. v. Wisconsin Dept. of Taxation, 322 U.S. at 441-442.[2]

As the Ohio Supreme Court stated in its opinion below, "[i]t is difficult to imagine a more fundamental exertion of a state's taxing power than where the state taxes income on winnings from its lottery." App. A. 8a. A review of the nature of the event from which the income arose and the facts bears out this statement. The sole source of all of the income subjected to Ohio income tax was an event that occurred wholly and uniquely within Ohio -- the playing and winning of the Ohio lottery. *See* Ohio Revised Code Chapter 3770. The Ohio lottery is conducted exclusively within the State and is subject to regulation by the State. Ohio law defines the nature and extent of the rights [illegible]hose who participate in the Ohio lottery. Not only

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[2] Contrary to the Couchots' claim (Pet. at 5, 11), the Ohio Supreme Court did not rely exclusively on *International Harvester*; it cited numerous other cases which supported the Court's holding. App. A. 7a. *International Harvester* is, however, the controlling authority and the holding in that case is both relevant and correct.

did the event out of which all of the income at issue arose occur in Ohio, but by its very nature it could have occurred only in Ohio.

Mr. Couchot physically entered Ohio for the purpose of playing the Ohio lottery. He purchased his lottery ticket in Ironton, Ohio. The lottery drawing in which the numbers on Mr. Couchot's ticket were selected as the winning numbers was conducted in Ohio. The prize was awarded and claimed in Ohio. Thus, the income that Ohio taxed arose directly and exclusively from Mr. Couchot's purchase in Ohio of an Ohio lottery ticket. Not only did Ohio have sufficient minimum contacts with this event, it had all of the relevant contacts.

This pervasive connection between the event out of which the income sought to be taxed arose and Ohio far exceeds the minimum contacts or nexus required to meet the requirements of the Due Process or Commerce Clauses. The Ohio Supreme Court properly so held. While the Ohio Supreme Court did hold that the physical-presence requirement reaffirmed in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), in the area of out-of-state sellers' liability to collect and remit sales and use tax had not been adopted by this Court concerning other types of state taxes, as this Court expressly stated in *Quill*, 504 U.S. at 317, what the Couchots conveniently and consistently ignore is that the Ohio Supreme Court did not stop there. Instead, that Court held that even if the physical-presence requirement was applicable it was satisfied. App. A. 11a. It clearly was. As the Ohio Supreme Court pointed out, Mr. Couchot physically entered Ohio for the specific purpose of engaging in the very activity out of which the income arose -- playing the Ohio

lottery. He also came into Ohio to claim his prize.[3]

The decision of the Ohio Supreme Court falls squarely within the holding in *International Harvester*. *International Harvester* held in no uncertain terms that a state may tax the income of a nonresident which is attributable to events occurring in the state.

The holding of the Ohio Supreme Court was a narrow one, and one supported by well-established precedent. Nor, contrary to the Couchots' bare assertions, is that holding in conflict with any other state or federal court. Not a single decision cited by the Couchots is in any way in conflict with the opinion below. In point of fact, it is consistent with the only other state court decision which addressed the same issue, *Stark v. Comptroller*, 554 A.2d 458 (Md. Ct. of Special Appeals 1989), *cert. denied*, 559 A.2d 791 (Md. 1989).

II. The Ohio Supreme Court Correctly Held That A State May Impose Its Income Tax On The Winnings Of A Nonresident From Playing And Winning That State's Lottery.

The Ohio Supreme Court did not hold that Ohio has the power to impose its income tax on Mr. Couchot, a nonresident. Its holding was much narrower. It held only that Ohio could impose its income tax on that part of Mr. Couchot's income that arose out of Mr. Couchot's playing

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[3] The Couchots' incredulity at the fact that under the State's position nexus "lasts" for twenty years (Pet. at 5) fails to discern the plain fact that the nexus with the income at issue "lasts" for that period simply because the income from the Ohio event -- the playing and winning the Ohio lottery -- is paid out over a twenty-year period.

and winning the Ohio lottery, an event that occurred wholly within Ohio.[4] That, of course, is precisely the holding of *International Harvester*.

The Couchots' contention that the Ohio Supreme Court's decision raises substantial questions regarding the authority of states to tax income of foreign corporations which have no physical presence in the state grossly overstates that decision. The case does not involve a tax on corporations. Moreover, although the Ohio Supreme Court noted that *Quill* stated that the physical-presence test had not been adopted outside the sales and use tax area, it held only that the test was not applicable in this case which involves only personal income taxes. More importantly, the Ohio Supreme Court held that even if that requirement were applicable, it was satisfied because Mr. Couchot physically entered Ohio to purchase the lottery ticket at issue. Thus, even if this Court might consider it important to decide whether the physical-presence test should be applied to a state's imposition of corporate income taxes on income of foreign corporations, this case is not the appropriate vehicle. This case simply does not present that question.

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[4] The Couchots are plainly wrong when they assert that the constitutional question is not whether Ohio has the authority to tax the income from an event which occurred in Ohio but whether Ohio has authority to tax Mr. Couchot. Pet. at 6 n. 5. The Couchots' statement that the location of the event which produced the income is not relevant to a determination of the State's authority to tax exemplifies the illogic of their argument. It is precisely because it is an income tax which is at issue that the location of the event out of which that income arose is not only relevant, but critical. As *International Harvester*, *Shaffer v. Carter*, 252 U.S. 37 (1920) and *Travis v. Yale & Towne Mfg. Co.*, 252 U.S. 60 (1920) confirm, whether a state has nexus to tax income of a nonresident depends solely on whether the income sought to be taxed arises from an event which occurred in the State. The connection with the State must necessarily relate to the income, because that is what is being taxed.

III. *In Re State Tax On Foreign-Held Bonds* Is Inapposite And Of Questionable Vitality.

The Couchots' argument that the Ohio Supreme Court's decision is in conflict with *In re State Tax on Foreign-Held Bonds*, 82 U.S. (15 Wall.) 300 (1872), is clearly wrong. As the Couchots concede, the tax at issue in *In re State Tax on Foreign-Held Bonds* was a property tax, not an income tax; it thus is inapposite for that reason alone.[5] But even if the income at issue arose out of intangible personal property rather than out of an event, the situs of that property for tax purposes would be irrelevant. With respect to income, the relevant consideration is the location of the source of the income at issue.

In re State Tax on Foreign-Held Bonds is inapposite in still another respect. The bonds at issue in that case were held outside of the taxing state. 82 U.S. (15 Wall) at 325. Its holding thus has been limited to the narrow proposition that bonds held out-of-state cannot be taxed. *Savings & Loan Society v. Maltnowah County*, 169 U.S. 421, 428 (1897); *Blackstone v. Miller*, 188 U.S. 189, 206 (1902).

In all events, reliance on *In re State Tax on Foreign-Held Bonds* for the view that intangible property could only be taxed by the state of the owner's domicile fails for a more fundamental reason. That proposition, adopted in *Farmers' Loan & Trust Co. v. Minnesota*, 280 U.S. 204 (1929), and followed in *First Bank of Boston v. Maine*, 284 U.S. 312

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[5] Even if property which is the source of the income sought to be taxed by a state is immune from taxation by that state, the income is not clothed with that immunity; whether such income can be taxed by the state is not affected by the character of the property which is its source. *New York ex rel. Cohn v. Graves*, 300 U.S. 308, 313-314 (1937).

(1931), was repudiated in *Curry v. McCanless*, 307 U.S. 357 (1939), and expressly overruled in *State Tax Commission v. Aldrich*, 316 U.S. 174 (1942). The holding in *Curry* is clear:

> Shares of corporate stock may be taxed at the domicile of the shareholder and also at that of the corporation which the taxing state has created and controls; *and income may be taxed both by the state where it is earned and by the state of the recipient's domicile.*

307 U.S. at 368 (emphasis added). The "sweeping" nature of *Curry* and its repudiation of *Farmers' Loan* has been noted by commentators. 2 J. Hellerstein & W. Hellerstein, State Taxation ¶21.14[1], at 21-43 (2d ed. 1992).

Nor do *Shaffer v. Carter, supra*, and *Travis v. Yale & Towne Mfg. Co., supra*, lend any support to the Couchots' argument. Instead, they support the holding below. Both *Shaffer* and *Travis* properly focused their nexus inquiry on the income being taxed, not on the person or entity receiving that income. *Shaffer* clearly noted that a state could impose a tax "upon incomes accruing to nonresidents from their property or business within the state ...." 252 U.S. at 52.

The claim that *Shaffer* and *Travis* set the outer limits of a state's power to tax the income of a nonresident reads those decisions too narrowly and ignores *International Harvester*. *Shaffer* and *Travis* simply addressed the type of income involved in those cases. Neither decision held that a state could not tax income of a nonresident which arose out of a source within the state unless that source was a business operation or work performed. Any such notion is rejected by *International Harvester* which broadly applied the language of *Shaffer*. *See* Hellerstein & Hellerstein, *supra*,

¶20.05[1], at 20-15 n. 76. This Court's reference to the *Shaffer* holding in *Oklahoma Tax Comm'n v. Chickasaw Nation*, 115 S.Ct. 2214, 2222 n. 11 (1995) does not support the Couchots' narrow view:

> ... as to nonresidents, "the tax is only on such income as is derived from ... sources [within the State]." (bracketed material by the Court).

The Couchots' statement that this Court has never expanded *Shaffer's* reach to a nonresident who lacks a physical presence in the taxing state likewise ignores *International Harvester* in which the Court stated that "the fact that the stockholder-taxpayers never enter Wisconsin ... cannot deprive it of its jurisdiction to tax." 322 U.S. at 443. See also *New York ex rel. Whitney v. Graves*, 299 U.S. 366 (1937) (income of nonresident from the sale of an interest in membership on New York Stock Exchange taxable by New York even where taxpayers never physically entered New York.) Moreover, whether physical presence is a requirement is not relevant in this case because, as discussed earlier, Mr. Couchot had a physical presence in Ohio -- he physically entered Ohio to participate in the very event out of which the income arose. The Couchots' constant focus on physical presence is simply a red herring.

IV. *International Harvester* Is Relevant, Correct And Controlling.

The assertion that *International Harvester* is irrelevant or wrong lacks merit. *International Harvester* held in no uncertain terms that a state may tax the income of a nonresident which is attributable to events or transactions occurring within the state. The tax at issue in that case was not imposed on the corporation, but was, as the Court said,

"in point of substance laid upon and paid by the stockholders ...." 322 U.S. at 443-444. The Couchots' point that this Court has cited *International Harvester* regarding the authority of a state to tax the income of foreign corporations misses the fact that the same principle is applicable to both nonresident individuals and foreign corporations. This Court noted this fact in the very footnote in *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 356 n. 18 (1954), referenced by the Couchots. What the Couchots fail to note is that the correctness of the holding in *International Harvester* has never been questioned in any subsequent decision of this Court.

The Couchots state that the fact alone that *International Harvester* was decided prior to *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1976), raises substantial doubts as to its vitality. They fail, however, to give any explanation for this statement. *Complete Auto* did not effect a change in the nexus requirement. It addressed and rejected the formalistic distinction between "direct" and "indirect" taxes on interstate commerce that had been applied in earlier decisions. *See Quill Corp.*, 504 U.S. at 310. In fact, the Couchots' reliance on *Quill* fails to recognize the fact that the Commerce Clause nexus test for sales and use taxes upheld in that case was one adopted in *National Bellas Hess, Inc. v. Department of Revenue of Ill.*, 386 U.S. 753 (1967), which itself was decided prior to *Complete Auto*.

V. The Decision Of The Ohio Supreme Court Is Not In Conflict With Decisions Of Any Other State Or Federal Court.

The Couchots' contention that the decision below is in conflict with those of other state and federal courts is wrong. Not a single one of the decisions cited by the Couchots involved a personal income tax, or any income tax

imposed on income that arose directly and exclusively out of an event which occurred within the taxing state. There is no decision that has questioned the constitutional authority of a state to exercise its power of taxation over such income of a nonresident individual or corporation.[6]

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[6] Instead, the cases cited involve: (i) sales taxes, *Laptops Etc., Corp. v. D.C.*, 164 B.R. 506 (Bankr. D.Md. 1993) (physical presence necessary to enable the State to impose tax collection obligation upon the vendor); (ii) corporate income and franchise taxes, *Watlow Winona, Inc. v. Comm'r of Revenue*, 495 N.W.2d 427 (Minn. 1993) (whether business was unitary, thus allowing State to include all income, not just that arising directly from activity in the State, in the apportionable income under the unitary business principle; Court also held that *Quill* effected no change in the applicable legal principles and was simply not on point), *Erieview Cartage, Inc. v. Pa.*, 654 A.2d 276 (Pa. Commw. Ct. 1995) (physical-presence test not referenced or applied; *Quill* cited only in Due Process Clause portion of the opinion), *Lawrence Industries, Inc. v. Sharp*, 890 S.W.2d 886 (Tex. App. 1994) (decision included only a Due Process Clause issue; it contained no reference to the physical-presence requirement of *Quill*), *Polychrome Int'l Corp. v. Krigger*, 5 F.3d 1522 (3d Cir. 1993) (No reference to or adoption of physical-presence test); (iii) a county business activity license tax, *Short Brothers (USA), Inc. v. Arlington County*, 423 S.E.2d 172 (Va. 1992); (iv) the unique Michigan Single Business Tax, *Gilette Co. v. Mich.*, 497 N.W.2d 595 (Mich. App. 1993), *appeal denied*, 519 N.W. 2d 156 (Mich. 1994), *cert. denied*, 115 S.Ct. 779 (1995) and *Guardian Indus. Corp. v. Mich.*, 499 N.W. 2d 349 (Mich. App. 1993), *appeal denied sub nom. Cargill Inc. v. Mich.*, 512 N.W. 2d 846 (Mich. 1994); (v) and personal property taxes, *Beelman Truck Co. v. Bd. of Equalization*, 861 S.W.2d 557 (Mo. 1993), *Diamond Shamrock Ref. & Mktg Co. v. Appraisal District*, 876 S.W. 2d 298 (Tex. 1994), *cert. denied*, 115 S.Ct. 500 (1994), *Vinmar, Inc. v. Appraisal District*, 890 S.W.2d 493 (Tex. App. 1994), and *Ryder Truck Rental, Inc. v. Chesterfield County*, 449 S.E.2d 813 (Va. 1994) (by their very nature, personal property taxes apply only to tangible personal property physically located in the state; not one of these cases contain any reference to *Quill's* physical-presence test; because the property at issue was in the taxing state in each case, physical presence was not an issue).

The Couchots' statement that the decision of the Ohio Supreme Court below and the decision of the South Carolina Supreme Court in *Geoffrey, Inc. v. South Carolina Tax Comm'n*, 437 S.E.2d 13 (S.C. 1993), *cert. denied*, 114 S.Ct. 550 (1993), are the only two decisions which have refused to adopt *Quill's* physical-presence test in an income tax context is misleading. Initially, *Quill* itself noted that the physical-presence test had not been adopted outside of the sales and use tax area. Second, the Ohio and South Carolina Supreme Courts are not in a minority of state courts on this issue. They are the only two state supreme courts that have been presented with the specific issue. There are no contrary decisions.

Even if there were inconsistent decisions on whether the physical-presence requirement applied to income taxes, this case would be an inappropriate vehicle for reviewing the issue: in this case, as the Ohio Supreme Court found and as the facts conclusively establish, there was a clear physical presence in Ohio and that physical presence was directly related to the income over which Ohio exercised its power of taxation. A clearer example of nexus is difficult to imagine.

VI. The Decision Of The Ohio Supreme Court Is Narrow With Clearly-Defined Boundaries.

The Couchots' claim that under the Ohio Supreme Court's decision the State's power to tax is boundless exaggerates the scope of the decision. The holding is both narrow and clearly-defined. The Ohio Supreme Court held that Ohio could impose its income tax on Ohio lottery winnings of a nonresident who entered Ohio to participate in the Ohio lottery and claimed his prize in Ohio. This was the only income which Ohio subjected to tax. The case does not involve whether Ohio could tax income of nonresidents from annuities purchased in Ohio, interest on accounts in Ohio

financial institutions or dividends paid by corporations doing business in Ohio. Instead, the income taxed is that arising out of an event or transaction which by its very nature is localized in Ohio. *Cf. New York ex rel. Whitney v. Graves*, 299 U.S. at 372-373. Ohio did not claim nexus over any other income.

The decision of the Ohio Supreme Court is in full accord with the decisions of this Court. As in *International Harvester*, the incidence of the tax is tied to the income which the taxing state made possible. As in *Aldrich*, the payment depends upon and involves the law of the taxing state for its exercise. Not only did the income realized by Mr. Couchot depend upon and involve the laws of Ohio, but the event from which that income derived owed its very existence to those laws. The laws of Ohio, and only the laws of Ohio, made that income possible. Also, as in *Aldrich*, Ohio law defines the nature and extent of the right of the person entitled to the income and affords that person protection for those rights.

This case presents an even clearer situation than that in *International Harvester*. Unlike the nonresident stockholders in *International Harvester*, Mr. Couchot actually entered Ohio. His entry into Ohio was for the specific purpose of engaging in the very activity out of which the income arose. He entered Ohio to purchase a lottery ticket which purchase formed the contract out of which the income at issue arose. The annual payments to Mr. Couchot by the State are made pursuant to that contract entered into in Ohio and enforceable in Ohio. When reviewed in light of the actual holding and the facts, the decision is unassailable. It is both well-defined and correct. It does not warrant this Court's review.

CONCLUSION

For the foregoing reasons, the petition for writ of certiorari should be denied.

Respectfully submitted,

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